

Message Text

SECRET

PAGE 01 STATE 251836 TOSEC 160270

61

ORIGIN SS-25

INFO OCT-01 ISO-00 SSO-00 CCO-00 /026 R

DRAFTED BY EB/TOENDERS/IFD:PHBOEKER/EUR/RPE:EPREEG:JB

APPROVED BY EB - THOMAS O. ENDERS

S:AADAMS

S/S-O:MTANNER

DESIRED DISTRIBUTION

D, E, C, S/S, S/P, EUR, EB (ONLY)

----- 093443

O 230122Z OCT 75 ZFF4

FM SECSTATE WASHDC

TO USDEL SECRETARY IMMEDIATE

INFO AMEMBASSY PARIS IMMEDIATE

S E C R E T STATE 251836 TOSEC 160270

STADIS//////////

EXDIS

E.O. 11652:XGDS-3 TAGS: EGEN, PFOR

SUBJECT: STRATEGY PAPER FOR SUMMIT

REFERENCE: SECTO 16028

PARIS FOR ROBINSON, EYES ONLY, EXCLUSIVELY

1. FOLLOWING IS STRATEGY PAPER FOR SUMMIT WHICH HAS BEEN DEVELOPED WITH HARTMAN, S/P AND HORMATS. I AM SENDING THIS SIMULTANEOUSLY TO CHUCK ROBINSON IN PARIS WHO MAY COMMENT DIRECTLY. HORMATS IS WORKING ON A SCENARIO PAPER AND DRAFT COMMUNIQUE FOR YOUR RETURN.

I. OVERVIEW.

2. THE SUMMIT SHOULD BENEFIT ALL PARTICIPANTS BY DEMONSTRATING THAT THE INDUSTRIALIZED COUNTRIES CAN DEAL DECISIVELY WITH ECONOMIC PROBLEMS AND NOT REMAIN PASSIVE

SECRET

SECRET

PAGE 02 STATE 251836 TOSEC 160270

SUBJECTS TO FORCES BEYOND THEIR CONTROL. IN TERMS OF

HARD ECONOMIC INTEREST, HOWEVER, THE STRIKING CHARACTER-
ISTIC OF THE SUMMIT IS ITS ASYMMETRY.

3. THE U.S. ECONOMY IS PULLING STRONGLY OUT OF RECESSION
AND GREW AT A REMARKABLE ANNUAL RATE OF 11 PERCENT IN THE
THIRD QUARTER, ALTHOUGH THERE ARE STILL UNCERTAINTIES

ABOUT NEXT YEAR. JAPAN IS ALSO IN MODERATE UPSWING. BUT
THERE ARE LITTLE OR NO SIGNS OF RECOVERY IN GERMANY,
FRANCE, BRITAIN, ITALY AND CANADA. OTHERS LOOK TO THE
U.S. RECOVERY FOR POWERFUL STIMULUS; WE SEEK OUR EXPAN-
SIVE IMPULSE WITHIN OUR ECONOMY.

4. IN POLITICAL TERMS IT DOES THE AMERICAN PRESIDENT
NO HARM TO BE SEEN EXERCISING LEADERSHIP AMONG TROUBLED
ALLIES. BUT THE POLITICAL STAKES FOR THE OTHER COUN-
TRIES ARE MUCH MORE URGENT AND PRECISE: GISCARD FACES
ASSEMBLY ELECTIONS NEXT YEAR, AND WANTS TO SHOW HE IS DOIN
G SOMETHING ABOUT (OR AT LEAST IS NOT TO BLAME FOR)
ECONOMIC STAGNATION. SCHMIDT'S INTEREST IS NEARLY THE
SAME. MIKI WANTS TO GET PERSONAL EXPOSURE TO HOLD OFF
BETTER KNOWN LDP RIVALS AND POSSIBLY PREPARE FOR AN
ELECTION AS EARLY AS DECEMBER. MORO HAS TO BE THERE
FOR POLITICAL SURVIVAL. TRUDEAU WANTS TO BE THERE FOR
PRESTIGE. WILSON CAN USE THE MEETING TO SHOW THAT
HELP IS ON THE WAY AND THE UNIONS MUST ACCEPT THE GOVERN-
MENT'S WAGE CONTROLS.

5. WHAT THIS MEANS IS THAT PRESIDENT FORD WILL GO INTO
THE SUMMIT IN A POSITION OF ECONOMIC STRENGTH. BUT
IT ALSO MEANS THAT HE CANNOT EXERCISE THAT STRENGTH,
OR PROJECT IT TO THE PUBLIC, IF HE DOES NOT ALSO HAVE
DEMANDS TO MAKE ON THE SIX. THESE DEMANDS ARE TWOFOLD:

-- THE PRESIDENT SHOULD ASK THAT OTHERS TAKE SUCH
FURTHER STIMULATIVE ACTION AS IS REQUIRED TO MATCH
OUR OWN STRONG RECOVERY, RATHER THAN MERELY RELY ON
THE STIMULUS OUR GROWTH GIVES WORLD TRADE.

-- THE PRESIDENT SHOULD SEEK THREE LONG-TERM IMPROVE-
SECRET

SECRET

PAGE 03 STATE 251836 TOSEC 160270

MENTS IN THE WORLD ECONOMY.

6. FIRST, IN THE MONETARY SYSTEM. THE BREAK FROM
BRETTON WOODS AND FIXED PARITIES GAVE US IN ECONOMICS
THE MOBILITY DETENTE AND THE OPENING TO CHINA GAVE US IN
INTERNATIONAL POLITICS. NO LONGER THE FIXED CENTER POLE
OF A WORLD SYSTEM, WE CAN NOW ASSURE THAT OUR CURRENCY
IS PRICED AT COMPETITIVE RATES, AND ARE ABLE TO RUN

OPTIMUM FISCAL AND MONETARY POLICIES WITH FAR LESS REGARD FOR OUR EXTERNAL PAYMENTS POSITION. BUT OTHER COUNTRIES, NOTABLY THE EUROPEANS, MAY HAVE LOST DEGREES OF FREEDOM. UNDER THE FIXED RATE SYSTEM, OTHERS WERE ABLE TO UNDERVALUE THEIR CURRENCIES BY PEGGING TO THE DOLLAR AT A LOW RATE, AND THUS GAIN A TRADE ADVANTAGE.

(THE IRONY IS THAT RESULTING U.S. DEFICITS CUMULATED OVER TIME WERE A MAJOR CAUSE OF THE COLLAPSE OF BRETTON WOODS.) UNDER THE CURRENT FLOATING SYSTEM, IN CONTRAST, COUNTRIES LIKE THE U.S. AND JAPAN THAT IMPORT AND EXPORT ONLY A SMALL PART OF THEIR TOTAL OUTPUT HAVE GREATER POTENTIAL ABILITY TO DEVALUE VIS-A-VIS MORE TRADE DEPENDENT ECONOMIES. THERE ARE TWO REASONS FOR THIS. FIRST, HIGHER IMPORT COSTS RESULTING FROM DEPRECIATION CREATE AN INFLATIONARY PUSH THROUGHOUT THE ECONOMY OFFSETTING THE COMPETITIVE ADVANTAGE DEPRECIATION GIVES EXPORTS, AND THIS IMPACT IS STRONGER ON HIGHLY TRADE DEPENDENT ECONOMIES. SECOND, CURRENCY DEPRECIATION CUTS INTO REAL PURCHASING POWER; THE LARGER THE IMPORT-EXPORT SECTOR, THE BIGGER THE CUT.

7. THE GREATER ABILITY TO DEVALUE GIVES THE U.S. AND JAPAN SUBSTANTIAL LEVERAGE OVER THE EUROPEANS UNDER THE PRESENT SYSTEM OF MOVING RATES. BUT IF WE TAKE ADVANTAGE OF THAT LEVERAGE (AS WE DID IN THE DOLLAR SLUMP THIS SPRING) WE WILL SOONER OR LATER FORCE A PROTECTIVE REACTION: EUROPEAN IMPOSITION OF QUANTITATIVE RESTRICTIONS ON TRADE AND FINANCE. THIS WOULD DEPRIVE US OF MUCH OF THE TRADE-EXPANDING, CAPITAL-ATTRACTING EFFECTS OF DOLLAR DEPRECIATION. IT COULD LAUNCH US ON A SPIRAL OF COMPETITIVE RESTRICTIONISM.

SECRET

SECRET

PAGE 04 STATE 251836 TOSEC 160270

8. AT SOME POINT BEFORE SUCH A REACTION, IT IS IN OUR INTEREST TO COMPROMISE ON A SYSTEM THAT (A) PRESERVES A LARGE MEASURE OF FLEXIBILITY FOR US, BUT (B) PROTECTS THE HIGH-TRADING ECONOMIES FROM EXCESSIVE DOLLAR DEPRECIATION.

9. WE ARE NOWHERE NEAR SUCH A PROTECTIVE REACTION NOW, AND ARE NOT UNDER PRESSURE. THEREFORE IT IS A GOOD TIME TO TRY TO NEGOTIATE A COMPROMISE. TREASURY HAS BEEN ATTEMPTING TO DO SO FOR THE LAST TWO WEEKS, USING THE SUMMIT AS A FOIL. IT IS IMPORTANT TO RECOGNIZE THAT SUCH A COMPROMISE, IF REACHED, CAN BE NO MORE THAN A VARIANT ON THE PRESENT SYSTEM OF MANAGED FLOATING RATES. THE FORCES LOOSE IN THE EXCHANGE MARKETS ARE SO STRONG THAT NO ATTEMPT TO REINSTATE THE STATUS QUO

ANTE WOULD BE OPERATIVE. WE NEED RATHER TO BEGIN A PROCESS OF COORDINATED BEST EFFORTS TO MODIFY THE CURRENT SYSTEM AND THEREBY TO REDUCE EXCESSIVE EXCHANGE RATE FLUCTUATION.

10. IF A DEAL IS STRUCK BEFOREHAND, THE SUMMIT SHOULD BLESS IT. IF NOT, THE SUMMIT SHOULD CALL FOR NEW EFFORTS. WE SHOULD NOT ATTEMPT TO NEGOTIATE A DEAL ON MONEY AT THE SUMMIT, BUT WE SHOULD ENSURE A GOOD TRACK RECORD UP TO THAT POINT OF SERIOUS EFFORTS TO REACH A REASONABLE SETTLEMENT.

11. OUR SECOND LONG TERM INTEREST IS THE INTERNATIONAL TRADING SYSTEM. HERE WE HAVE LOST OUR WAY BECAUSE MOVING RATES CHANGED THE GAME AND BECAUSE OF THE RECESSION. WE ARE WINGING IT CASE BY CASE.

12. AND YET OUR STAKE IN AN OPEN TRADING SYSTEM IS ENORMOUS. TRADE HAS BEEN THE MAJOR GROWTH INDUSTRY IN THE WEST FOR THE LAST GENERATION CONSISTENTLY OUTPERFORMING THE REST OF OUR ECONOMY. TRADE IS A MAJOR INSTRUMENT TO KEEP OUR ECONOMIES EFFICIENT AND COMPETITIVE. AND IT IS A POWERFUL MEANS OF ATTRACTING AND HOLDING ALLIES.

13. SOUND MONETARY AND TRADE POLICY ARE ESSENTIAL
SECRET

SECRET

PAGE 05 STATE 251836 TOSEC 160270

TO EACH OTHER. IT DOES NO GOOD TO HAVE THE RIGHT MONETARY ARRANGEMENTS IF TRADE RESTRICTIONS PROLIFERATE. IT WILL NOT BE POSSIBLE TO MAINTAIN AN OPEN TRADING SYSTEM IF CURRENCIES FLUCTUATE WIDELY AND ARE CONSISTENTLY OVER AND UNDER VALUED.

14. IT SHOULD BE THE BUSINESS OF THE SUMMIT TO SET NEW GOALS FOR THE INTERNATIONAL TRADING SYSTEM. BECAUSE TARIFFS ARE ALREADY LOW AND BECAUSE OF THE MOVING RATE SYSTEM, A BROAD NEW TARIFF CUT IS OF SECONDARY IMPORTANCE. BUT FOUR OTHER ELEMENTS ARE ESSENTIAL: (A) IMMEDIATE NEGOTIATION OF A FAR MORE INNOVATIVE CODE ON SUBSIDIES AND COUNTERVAILING THAN WE ARE NOW CONSIDERING; (B) DEVELOPMENT OF SPECIALIZED TRADE REGIMES FOR KEY SECTORS SUCH AS STEEL AND ALUMINUM, CONSISTING OF A BALANCED NETWORK OF TARIFF CUTS (OFTEN FREE TRADE MAY BE APPROPRIATE); REMOVAL OF NON-TARIFF BARRIERS; SUPPLY ACCESS UNDERTAKINGS, AND PROTECTION AGAINST MARKET DISRUPTION; (C) A MAJOR STEP FORWARD IN AGRICULTURE BY NEGOTIATION OF THE GRAINS RESERVES PROPOSAL, AND (D) COMMITMENT BY ECONOMIC POLICY MAKERS TO INCLUDE GROWTH OF WORLD TRADE AS ONE OF THE OBJECTIVES WHEN

ESTABLISHING THE MIX OF MONETARY, FISCAL AND OTHER DOMESTIC POLICIES.

; SECRET

15. THE SUMMIT CANNOT CONSIDER TRADE IN ANY DETAIL. BUT IT CAN SET THE GOALS AND A TIMETABLE. THE LATTER SHOULD CALL FOR EARLY PROGRESS IN THE MTNS DESPITE THE RECESSION AND U.S. ELECTIONS.

16. THE THIRD LONG-TERM INTEREST IS COORDINATION OF OVERALL ECONOMIC POLICY. WE ALL WANT TO BE ABLE TO RUN OUR ECONOMIES CLOSER TO THEIR CAPACITY, WITHOUT CREATING UNDUE INFLATIONARY PRESSURE. COORDINATION, WE FEEL INSTINCTUALLY, SHOULD HELP US REACH THAT GOAL.

17. YET IT MAY NOT. IF IT RESULTS IN SYNCHRONIZATION OF BOOMS AND BUST THROUGHOUT THE INDUSTRIAL WORLD, SUCH AS WE EXPERIENCED THESE LAST TWO YEARS, POLICY COORDINATION IS CLEARLY UNDESIRABLE. IN OTHER CASES "COORDINATION" MEANS MERELY A DEMAND FOR A CONCESSION: FOR

PAGE 06 STATE 251836 TOSEC 160270

EXAMPLE, SCHMIDT WANTS US SOMEHOW TO TAKE THE CONTRADICTORY ACTIONS OF LOWERING OUR INTEREST RATES AND RAISING OUR EXCHANGE RATE, SO THAT GERMANY CAN SIMULTANEOUSLY INCREASE ITS EXPORTS AND INTERNAL LIQUIDITY, WHILE THE REVERSE OCCURS HERE.

18. BECAUSE OUR ECONOMY IS SO MUCH LESS TRADE DEPENDENT THAN THOSE OF THE OTHER SIX, POLICY COORDINATION WILL LIKELY GIVE THE U.S. LESS THAN IT GIVES THEM. WE SHOULD ESTABLISH FOCUSED POLICY COORDINATION INSTITUTIONS WITH CLEARLY DELINEATED OBJECTIVES AND IN PARTICULAR TO BACK UP THE AGREEMENTS ON MONEY AND TRADE. WE SHOULD NOT

AGREE TO REGULAR MEETINGS OF THE SEVEN AT HEADS OF GOVERNMENT LEVEL, BUT WE SHOULD LEAVE OPEN THE POSSIBILITY OF A FOLLOW-UP SUMMIT AFTER THE ELECTION TO ASSESS PROGRESS IN THE INTERIM.

19. THE SUMMIT WILL ADDRESS TWO OTHER PROBLEMS, NORTH/SOUTH DIALOGUE (PARTICULARLY NEXT YEAR'S CRITICAL PAYMENTS FINANCING PROBLEM FOR LDCS) AND ENERGY, BUT FROM OUR VANTAGE LESS CONSEQUENTIALLY. SPECIFICS BELOW.

20. WHAT IS OUTLINED ABOVE IS A RELATIVELY AMBITIOUS SUMMIT. IT WOULD HAVE ITS DOMESTIC POLITICAL COSTS. SENATE FINANCE, SOME MEMBERS OF WAYS AND MEANS, AND IDENT WOULD RESIST U.S. COMMITMENT TO NEGOTIATE AN

INNOVATIVE SUBSIDIES CODE. HOUSE BANKING UNDER REUSS

" SECRET
(FOR DOCTRINAL REASONS), AND BURNS (FOR BUREAUCRATIC REASONS) WOULD PROBABLY OPPOSE ANY EFFORT TO LIMIT VARIATIONS IN THE VALUE OF THE DOLLAR, PARTICULARLY IF BACKED UP BY A CONSULTATIVE MECHANISM. WE COULD HAVE TREASURY SUPPORT ON BOTH. WE WILL NEED INTENSIVE DISCUSSION WITHIN THE EXECUTIVE BRANCH AS WELL AS CONSULTATION WITH CONGRESS BEFORE THE SUMMIT IF WE ARE TO HAVE BROAD SUPPORT FOR THIS PROGRAM.

SECRET

SECRET

PAGE 07 STATE 251836 TOSEC 160270

21. THE ALTERNATIVE OF A PASSIVE U.S. ROLE IS UNATTRACTIVE. ALTHOUGH OUR ECONOMIC AND POLITICAL STRENGTH IS INCREASING, WE WOULD APPEAR RESPONSIBLE FOR THE WORLD'S ECONOMIC ILLS. THE IMPRESSION OF OTHER LESSER POWERS CALLING THE SHOTS WOULD BE DAMAGING.

22. THE FOLLOWING SECTIONS IDENTIFY OUR OBJECTIVES IN EACH OF THE FIVE KEY AREAS (ECONOMIC POLICY COORDINATION, MONEY, TRADE, NORTH-SOUTH, AND ENERGY) GIVE ANALYTICS AND CURRENT STATE OF PLAY, AND DRAW CONCLUSIONS ON WHAT WE CAN AND CAN'T DO IN THE SUMMIT TO FURTHER OUR OBJECTIVES.

II. ECONOMIC POLICY COORDINATION

23. THERE ARE THREE DISTINCT YET RELATED QUESTIONS RAISED -- ECONOMIC RECOVERY AND PUBLIC CONFIDENCE THEREIN, CLOSER CONSULTATION AND COORDINATION OF ECONOMIC POLICIES, AND THE PROCEDURAL MECHANISM TO ACHIEVE IT.

U.S. OBJECTIVES

24. OUR OBJECTIVES ARE TO:

25. A. BUILD PUBLIC CONFIDENCE THAT GOVERNMENTS ARE TAKING THE NECESSARY STEPS TOWARD EARLY ECONOMIC RECOVERY AND, IN PARTICULAR, THAT FURTHER STIMULATIVE MEASURES BY THE U.S. ARE NOT REQUIRED AT THIS TIME.

26. B. AGREE AMONG THE PARTICIPANTS TO DEVELOP OVER TIME CLOSER COOPERATION AND COORDINATION OF ECONOMIC AND MONETARY POLICIES.

27. C. ESTABLISH A MECHANISM TO INSURE IMPLEMENTATION OF THE BROAD ECONOMIC AND MONETARY OBJECTIVES AGREED AT

THE SUMMIT, LEAVING OPEN WHETHER SUMMIT PARTICIPANTS WILL WISH TO REVIEW PROGRESS AT SOME LATER POINT (AFTER U.S. ELECTIONS).

THE STATE OF PLAY

SECRET

SECRET

PAGE 08 STATE 251836 TOSEC 160270

28. THE CURRENT RECESSION IS THE LONGEST AND DEEPEST SINCE WORLD WAR II. STRONG RECOVERY IS ALREADY UNDERWAY IN THE UNITED STATES, WHERE REAL GNP GREW AT AN ANNUAL RATE OVER 11 PERCENT IN THE THIRD QUARTER. JAPAN MAY BE ON THE UPSWING. DESPITE LARGE INJECTIONS OF POTENTIAL PURCHASING POWER, DEMAND HAS CONTINUED WEAK VIRTUALLY EVERYWHERE ELSE IN THE INDUSTRIAL WORLD. THE PRINCIPAL REASON IS LACK OF CONFIDENCE ON THE PART OF BOTH CONSUMERS, WHO ARE SAVING AT VERY HIGH RATES, AND INVESTORS WHO ARE MOVING SLUGGISHLY TO INVEST IN NEW CAPACITY. THE LOW CONFIDENCE LEVEL STEMS PRINCIPALLY FROM TWO SOURCES.

29. --WE HAVE LIVED THROUGH A PERIOD WHERE HIGH UNEMPLOYMENT RATES COEXISTED WITH A DEGREE OF INFLATION UNPRECEDENTED IN THE POST-WAR WORLD. THIS HAS FUELED PESSIMISTIC EXPECTATIONS REGARDING THE FUTURE ECONOMIC OUTLOOK. IT HAS ALSO DRAINED CONFIDENCE IN THE ABILITY OF GOVERNMENTS TO PURSUE POLICIES LEADING TO GROWTH WITH HIGH EMPLOYMENT AND REASONABLE PRICE STABILITY.

30. -- THE OIL EMBARGO AND FOUR-FOLD INCREASE IN OIL PRICES WHICH ENSUED WERE A SERIOUS SHOCK TO THE PSYCHE OF CONSUMERS AND INVESTORS. BOTH ARE UNCLEAR WHAT CHANGES IN THE RELATIVE PRICE OF ENERGY WILL MEAN FOR THEM. THE RESULT OF THIS UNCERTAINTY IS EXTREME CAUTION IN SPENDING DECISIONS.

31. IN THE FACE OF LAGGING DEMAND, SOME COUNTRIES, PARTICULARLY GERMANY, STILL HAVE SOME SCOPE FOR ADDITIONAL EXPANSIONARY ACTION, BUT NO MORE CAN BE EXPECTED OF THE U.S.

32. SHOULD SCHMIDT NEVERTHELESS COME AT US WITH ANOTHER LECTURE ON HOW THE U.S. SHOULD EXPAND FASTER TO PUMP UP EUROPE'S EXPORTS, WE WILL HAVE TO COUNTER BY ESTABLISHING THAT

33. -- WE ARE GROWING VERY FAST NOW

34. -- THIS WILL HAVE SOME, BUT NOT DECISIVE, EFFECT
SECRET

SECRET

PAGE 09 STATE 251836 TOSEC 160270

ON OTHERS

35. -- THE MOMENTUM FOR EUROPEAN GROWTH WILL HAVE TO BE INTERNAL.

36. THE DISCUSSION SHOULD BE MOVED TO THE PROBLEM OF CONFIDENCE AND WHAT THE SUMMIT CAN DO TO BOLSTER IT.

37. THE PROBLEM OF LONGER TERM COOPERATION CENTERS ON ASYMMETRICAL INTERDEPENDENCE. SINCE WORLD WAR II COUNTRIES HAVE BECOME STEADILY MORE INTERDEPENDENT AS A RESULT OF (A) THE RAPID GROWTH OF WORLD TRADE, (B) INNOVATIONS IN TRANSPORTATION AND COMMUNICATION, (C) THE SPREAD OF MULTINATIONAL COMPANIES, AND (D) A TENDENCY TOWARD CAPITAL MARKET UNIFICATION AFTER THE RETURN TO MAJOR CURRENCY CONVERTIBILITY. THE REPERCUSSIONS OF INTERDEPENDENCE ARE MOST EVIDENT IN EUROPE WHERE NATIONS ARE ECONOMICALLY INTERLOCKED TO A HIGH DEGREE BOTH WITH EACH OTHER AND WITH THE OUTSIDE WORLD. THE UNITED STATES IS MORE INSULATED FROM OUTSIDE ECONOMIC EVENTS BUT WHAT HAPPENS HERE HAS A MAJOR IMPACT ON OTHERS.

38. IT IS THEREFORE UNREALISTIC TO EXPECT DEVELOPED COUNTRIES, AND IN PARTICULAR THE U.S., TO SUBMIT DOMESTIC ECONOMIC POLICY DECISIONS FOR INTERNATIONAL APPROVAL. THERE IS, HOWEVER, ROOM TO STRENGTHEN THE PROBABILITY

THAT THE POLICY CHOICES OF INDIVIDUAL COUNTRIES ARE COMPATIBLE. ALL HAVE AN INTEREST IN PREVENTING A REPLAY OF THE EXPERIENCE IN THE EARLY 1970S WHEN SIMULTANEOUS EXPANSION BROUGHT THE WESTERN WORLD TO THE BRINK OF HYPERINFLATION.

39. EFFORTS TOWARD ACHIEVING MORE COMPATIBLE POLICIES SHOULD CONCENTRATE INITIALLY ON:

40. (A) AN IMPROVED UNDERSTANDING OF HOW AND WHY DOMESTIC POLICY MAKERS VIEW THEIR OWN ECONOMIC PROSPECTS IN A PARTICULAR WAY, HOW THIS FITS INTO THEIR VIEW OF THE WORLD ECONOMIC OUTLOOK AND HOW THEIR OWN POLICY ACTIONS, INCLUDING MIX OF POLICIES, FITS INTO THIS FRAMEWORK;

SECRET

SECRET

PAGE 10 STATE 251836 TOSEC 160270

41. (B) AN IMPROVED UNDERSTANDING OF THE TRANSMISSION OF CHANGES IN ECONOMIC ACTIVITY AND PRICE BEHAVIOUR ACROSS

NATIONAL BORDERS;

42. (C) A BROADENING OF THE DISCUSSION OF HOW, IN THE LIGHT OF (A) AND (B), NATIONAL POLICIES MIGHT IMPACT ON OTHERS IN PARTICULAR, AND ON THE WORLD ECONOMY IN GENERAL, WITH A VIEW TO DETERMINING WHETHER OR NOT SERIOUS INCONSISTENCIES AND INCOMPATIBILITIES REGARDING OBJECTIVES OR POLICIES EXIST AMONG NATIONS.

CONCLUSIONS

43. FOR THE NEAR-TERM THE IMPORTANT TASK IS TO GIVE CLEAR SIGNALS FROM THE SUMMIT THAT A) GOVERNMENTS ARE TAKING THE NECESSARY STEPS, B) RECOVERY IS A VIABLE PROPOSITION AND C) MAJOR COUNTRIES ARE WORKING TOGETHER TO INSURE THAT IT HAPPENS.

44. THE U.S. SHOULD AVOID AN OPEN ENDED COMMITMENT TO COORDINATE ECONOMIC POLICIES GIVEN THE UNAVOIDABLY DOMINANT ROLE OF DOMESTIC CONSIDERATIONS IN SETTING OPTIMUM POLICIES FOR THE U.S.

45. THE CENTRAL QUESTION IS WHETHER WE WISH TO INSTITUTIONALIZE IN SOME WAY A LIMITED GROUP SUCH AS THE SEVEN PARTICIPANTS, AND THUS SET IN MOTION A CONTINUING PROCESS OF INTERCHANGE AMONG THESE LARGEST INDUSTRIALIZED COUNTRIES, INCLUDING A POSSIBLE RECONVENING OF THE SUMMIT SOMETIME AFTER THE ELECTION. WE SHOULD ALSO BEAR IN MIND THE OECD MINISTERIAL NEXT SPRING AND A POSSIBLE INFORMAL PRE-MEETING OF MINISTERS FROM THE SEVEN SUMMIT PARTICIPANTS TO ASSESS PROGRESS IN THE INTERIM. ANY LIMITED GROUP, OF COURSE, WILL NOT BE POPULAR WITH SMALLER

COUNTRIES, AND ANY FOLLOW-ON OF THIS SORT WOULD HAVE TO BE LINKED IN SOME WAY WITH BROADER INSTITUTIONAL FORUMS.

46. THE BEST WAY TO LIMIT THE SCOPE OF A FOLLOW-ON MECHANISM MAY BE TO CONFINE ITS SCOPE TO CONSULTING ON
SECRET

SECRET

PAGE 11 STATE 251836 TOSEC 160270

IMPLEMENTATION OF ECONOMIC AND MONETARY DECISIONS OF

THE SUMMIT. EACH POSSIBLE MECHANISM ENTAILS DELICATE BUREAUCRATIC ISSUES WHICH WILL HAVE TO BE WORKED OUT BEFOREHAND. THERE ARE TWO BASIC OPTIONS:

47. A. THE FINANCE MINISTERS "LIBRARY GROUP", POSSIBLY EXPANDED TO THE 7 PARTICIPANTS. THIS WOULD BE THE MOST INFORMAL ARRANGEMENT, AND COULD BE PRESENTED AS ESSENTIALLY A MONITORING BODY TO INSURE THAT THE DIREC-

TION COMING FROM THE SUMMIT MEETING WAS PROPERLY TRANSMITTED TO THE VARIOUS EXISTING INSTITUTIONS DEALING WITH ECONOMIC AND MONETARY POLICIES.

48. B. FORTIFIED OECD ECONOMIC POLICY COMMITTEE (EPC) "BUREAU". THE OECD ECONOMIC POLICY COMMITTEE HAS A HIGHLY INFORMAL "BUREAU" WHICH IN FACT CONSISTS OF THE SEVEN PARTICIPANT COUNTRIES AT THE SUMMIT. THIS GROUP COULD BE FORTIFIED BY MORE SYSTEMATIC PREPARATION, BROADER AGENCY PARTICIPATION, AND MORE FREQUENT MEETINGS.

49. THE IMAGE OF INDUSTRIAL COUNTRY CONDOMINIUM COULD BE BLURRED BY BUILDING IN SOME ROLE FOR THE IMF INTERIM COMMITTEE (WHICH INCLUDES LDCS); BOTH THE EPC AND LIBRARY GROUP HAVE MET IN TANDEM WITH THE INTERIM COMMITTEE.

SECRET

III. MONEY

50. THE MONETARY ISSUES COULD BE THE KEY TO A SUCCESSFUL SUMMIT.

U.S. OBJECTIVES

51. OUR OBJECTIVES ARE:

52. --TO AVOID AN EXCHANGE SYSTEM WHICH WOULD OVER-VALUE THE DOLLAR AND THEREBY CONSTRAIN OUR DOMESTIC AND FOREIGN POLICIES IN SHORING IT UP

SECRET

SECRET

PAGE 12 STATE 251836 TOSEC 160270

53. --TO SETTLE WITHOUT SACRIFICING THIS PRIME OBJECTIVE, THE U.S.-FRENCH DISAGREEMENT OVER THE IMF ARTICLES' PROVISIONS ON THE EXCHANGE RATE SYSTEM

54. --TO AGREE ON COOPERATION TO DEAL WITH EXCESSIVE INSTABILITY OF EXCHANGE RATES IN THE MARKET

THE STATE OF PLAY

55. THERE ARE TWO BASIC DEMANDS THE FRENCH, WITH VARYING DEGREES OF EUROPEAN SUPPORT, HAVE MADE OF US. FIRST, THE FRENCH WISH TO AMEND THE IMF ARTICLES TO MAKE FLOATING RATES A DEVIATION FROM THE NORM, SUBJECT TO EXCEPTIONAL PROCEDURES, AND TO INSURE THE ULTIMATE AIM OF RETURN TO FIXED RATES FOR EVERYONE. SECOND, THE FRENCH AND MOST EUROPEANS WISH TO COMMIT US TO MORE ACTIVE INTER-

VENTION IN EXCHANGE MARKETS TO SUPPORT THE DOLLAR AND
REDUCE EXCHANGE RATE FLUCTUATIONS GENERALLY.

56. IN HIS INTRODUCTION OF MONETARY ISSUES GISCARD WILL
PRESENT THE EVILS OF EXCHANGE RATE INSTABILITY: IT
INHIBITS INVESTMENT, INCREASES PRESSURE ON WEAK INDUSTRI-
AL SECTORS, AND MAY RESTRAIN SOME INTERNATIONAL TRADE.
WE CAN AGREE TO DEAL WITH THESE PROBLEMS BY ADDRESSING
UNDERLYING ECONOMIC INSTABILITY AND BY SOME INTERVENTION
TO REDUCE ERRATIC EXCHANGE RATE FLUCTUATIONS, BUT NOT BY
LEGISLATING AN OBJECTIVE OF RETURN TO FIXED EXCHANGE
RATES IN THE IMF ARTICLES.

57. GISCARD WOULD LIKE THE IMF ARTICLES TO ASSERT THE
STANDARD CAN BE USED TO PRESSURE THE U.S. OVER COMING
YEARS ON INTERVENTION IN SUPPORT OF THE DOLLAR. HIS AIM
IS TO SECURE AN ENVIRONMENT IN WHICH FRENCH EXPORT
GROWTH, SUPPORTED BY UNDERVALUED FRANC, WILL LEAD THE

FRENCH ECONOMY TO MORE RAPID GROWTH THAN IN GERMANY, THUS
PROMOTING BOTH THE FRENCH ECONOMY AND FRENCH LEADERSHIP
IN THE EC.

58. SCHMIDT IS FLEXIBLE ON BOTH MONETARY ISSUES AND
SECRET

SECRET

PAGE 13 STATE 251836 TOSEC 160270

ANXIOUS TO PLAY THE ROLE OF THE GREAT COMPROMISER WHO
ASSURES THE SUCCESS OF THE SUMMIT BY BRIDGING U.S. AND
FRENCH DIFFERENCES. MIKI, WILSON AND MORO WILL WANT TO
LEAVE THE IMF ARTICLES TO THE U.S. AND FRANCE TO WORK
OUT. THEY WILL CONSIDER THE ISSUE OF INTERVENTION POLICY
AS MAINLY ONE BETWEEN THE SNAKE CURRENCIES AND THE U.S.

59. IN THEIR EXTREME FORM THE FRENCH POSITION ON THE IMF
ARTICLES AND INTERVENTION CALL FOR A RETURN TO THE EX-
CHANGE RATE SYSTEM WHICH EXISTED BEFORE AUGUST 1971 WHEN
WE FIRST FLOATED AND THEN DEVALUED THE DOLLAR. THIS
CANNOT BE DONE BECAUSE OF THE CHANGED BALANCE OF ECONOMIC
POWER AND GREATER INSTABILITY IN THE WORLD ECONOMY. THE
OLD SYSTEM BROKE DOWN BASICALLY BECAUSE THE U.S. NO
LONGER HAD THE ECONOMIC PRE-EMINENCE OR POWER TO MAINTAIN
A FIXED RATE AGAINST WHICH OTHERS COULD CONTINUALLY
DEVALUE THEIR CURRENCIES TO MAINTAIN A COMPETITIVE EDGE
AGAINST THE DOLLAR. CONTINUOUS HIGH INFLATION HAS NOW
CREATED AN ADDITIONAL BARRIER TO FIXED RATES FOR ALL
COUNTRIES IN THAT IT HAS GENERATED A MOUNTAIN OF SHORT-
TERM FINANCIAL CLAIMS WHICH CAN READILY SHIFT FROM ONE
CURRENCY TO ANOTHER AND OVERWHELM CENTRAL BANKERS' EFFORTS
TO COUNTER THE RESULTING EXCHANGE RATE MOVEMENTS. RECENT
UNSUCCESSFUL EFFORTS OF EUROPEAN CENTRAL BANKS TO

DEPRECIATE THEIR CURRENCIES AGAINST THE DOLLAR THROUGH MARKET INTERVENTION HAVE BROUGHT HOME THIS FACT TO MOST OF THEM.

60. WHILE RECOGNIZING IN LARGE MEASURE THE IMPOSSIBILITY OF RETURN AT ANY EARLY DATE TO FIXED EXCHANGE RATES, EUROPEANS REMAIN FRUSTRATED AT THEIR INABILITY TO ASSURE A COMPETITIVE EDGE AGAINST THE DOLLAR UNDER THE CURRENT SYSTEM. MASSIVE MOVEMENTS OF SHORT-TERM CAPITAL MAKE IT IMPOSSIBLE FOR CENTRAL BANKS TO ENGINEER A COMPETITIVE UNDERVALUATION OF THEIR CURRENCIES. AT THE SAME TIME, EFFORTS TO ACHIEVE THE SAME COMPETITIVE EDGE BY EXPORT AND SECTORAL SUBSIDIES ARE NEUTRALIZED BY EXCHANGE RATE APPRECIATION. IN EFFECT, THE EUROPEANS AND JAPANESE ARE NO LONGER GUARANTEED THAT THEY CAN WIN A MERCANTILIST GAME VIS-A-VIS THE U.S.

SECRET

SECRET

PAGE 14 STATE 251836 TOSEC 160270

61. BEHIND THE DISCUSSION OF THE EXCHANGE RATE SYSTEM, THEREFORE, IS THE EUROPEAN'S FUNDAMENTAL UNHAPPINESS WITH

THE EXCHANGE RATE RELATIONSHIP THAT WE ACHIEVED BY FLOATING THE DOLLAR.

WHETHER BY A RETURN TO FIXED RATES OR GREATER INTERVENTION IN SUPPORT OF THE DOLLAR UNDER A MANAGED FLOATING SYSTEM, THE EUROPEANS HOPE TO ACHIEVE A BIAS TOWARD AN EXPENSIVE DOLLAR.

CONCLUSIONS

62. THE KEY JUDGMENT IS WHETHER OR NOT EXTRAVAGANT EUROPEAN EXPECTATIONS FOR NEW EXCHANGE RATE RULES HAVE BEEN SUFFICIENTLY DEFLATED TO ENABLE US TO NEGOTIATE A COMPROMISE WHICH BOWS TO EUROPEAN THEOLOGY AND DEALS WITH THEIR CONCERNS ON EXCESSIVE EXCHANGE RATE INSTABILITY, WITHOUT AFFECTING OUR FREEDOM TO MANAGE OUR DOMESTIC ECONOMY. (ED YEO'S DISCUSSIONS WITH THE FRENCH SO FAR INDICATE SOME GROUNDS FOR OPTIMISM.) IF THE FRENCH WILL CONCEDE THE BASIC POINT THAT FLOATING AND FIXED RATES ("PAR VALUES") MUST BOTH BE SANCTIONED INDEFINITELY BY THE IMF ARTICLES, THEN WE HAVE CONSIDERABLE FLEXIBILITY TO DEAL WITH OTHER EUROPEAN CONCERNS ON MONETARY ISSUES.

63. WE SHOULD AIM FOR AN AGREEMENT ON THE IMF ARTICLES WHICH HAS SOME FACE-SAVING LANGUAGE FOR THE FRENCH ON A "STABLE SYSTEM OF EXCHANGE RATES", "GREATER STABILITY IN EXCHANGE RELATIONSHIPS", ETC, BUT INDEFINITE LICENSE FOR FLOATING AS A NATIONAL OPTION TO A FIXED RATE. HOPEFULLY, AGREEMENT ON LANGUAGE CAN BE REACHED BY YEO

AND HIS FRENCH COUNTERPART, FOR THE HEADS OF GOVERNMENT TO ENDORSE. IF YEO CANNOT REACH AGREEMENT, WE SHOULD TRY TO PUSH THE SUBSTANTIVE NEGOTIATIONS BACK TO THIS LEVEL, WITH THE HEADS OF GOVERNMENT AGREEING THIS SHOULD BE SETTLED BY JANUARY.

64. ON INTERVENTION POLICY, WE SHOULD AGREE THAT RECENT EXCHANGE RATE FLUCTUATIONS HAVE BEEN EXCESSIVE AND THAT MORE EFFECTIVE, COORDINATED INTERVENTION IS NEEDED TO REDUCE ERRATIC SHORT-TERM MOVEMENTS. WE SHOULD ALSO AGREE
SECRET

SECRET

PAGE 15 STATE 251836 TOSEC 160270

THAT ANY MECHANISM FOR CLOSER CONSULTATION ON MEDIUM-TERM ECONOMIC PROSPECTS AND POLICIES SHOULD INCLUDE A LINKAGE THAT WOULD ENABLE CENTRAL BANKERS TO TAKE THESE DELIBERATIONS INTO ACCOUNT IN THEIR DISCUSSIONS OF INTERVENTION. THIS WILL REQUIRE AN INVITATION TO THE CENTRAL BANKERS' BASLE GROUP TO TAKE ON THIS TASK AND SOME NEW BUT NECESSARILY INFORMAL LINKAGE BETWEEN THE BANKERS AND ANY FOLLOW-ON ECONOMIC POLICY CONSULTATION.

65. WE CAN PERHAPS AGREE TO SETTING AN OBJECTIVE OF MORE

EFFECTIVE MANAGEMENT OF A FLOATING RATE SYSTEM AS ONE PURPOSE OF CLOSER CONSULTATION ON ECONOMIC POLICY. WE SHOULD RESIST, HOWEVER, ANY EFFORT TO ESTABLISH TARGET BANDS OF FLUCTUATION FOR THE DOLLAR VIS-A-VIS THE EUROPEAN SNAKE OR OTHER CURRENCIES. SUCH TARGET BANDS WOULD UNNECESSARILY EXPOSE THE SUMMIT'S RESULTS TO POLITICAL AND ECONOMIC FAILURE. HENRY REUSS AND A HOST OF OTHERS WOULD DENOUNCE SUCH AN ARRANGEMENT SO VIOLENTLY THAT IT WOULD MAKE THE SUMMIT RESULT A HIGHLY PARTISAN ONE. A SPECULATIVE TEST OF ANY BANDS OF FLUCTUATION COULD QUICKLY PROVE CENTRAL BANKERS' INABILITY TO MAINTAIN THEM, THUS BELYING THE SUMMIT UNDERTAKING.

66. THE GERMANS MAY SEEK A DECLARATION BY THE HEADS OF GOVERNMENT ON A GENERAL REDUCTION IN INTEREST RATES. THIS IS VERY DIFFICULT FOR THE PRESIDENT TO HANDLE; IT IS IN FACT IMPOSSIBLE FOR HIM POLITICALLY TO SAY ANYTHING ABOUT INTEREST RATES WITHOUT SETTING UP AN EXCHANGE OF PUBLIC STATEMENTS BETWEEN HIMSELF AND ARTHUR BURNS. THIS MAY ARGUE FOR FINDING A WAY TO MAKE A ROLE FOR BURNS.

67. THE BRITISH MAY SEEK SOME SORT OF PUSH FOR EARLY ESTABLISHMENT OF THE FINANCIAL SUPPORT FUND, SINCE THEIR NEED FOR CREDIT COULD BE QUITE MASSIVE AND IMMINENT. A SUMMIT ENDORSEMENT OF EARLY ACTION ON THE SUPPORT FUND SHOULD HELP GET CONGRESSIONAL ACTION.

SECRET

IV. TRADE

SECRET

SECRET

PAGE 16 STATE 251836 TOSEC 160270

68. A FORWARD U.S. POSITION ON TRADE ISSUES WILL MAKE THE MONETARY ISSUES EASIER TO HANDLE AND WILL BECOME CRUCIAL TO A SUCCESSFUL SUMMIT IF WE CANNOT PRECOOK A MONETARY COMPROMISE.

U.S. OBJECTIVES

69. OUR OBJECTIVES ARE TO:

70. A. TO LOCK THE EUROPEANS, JAPANESE, AND OURSELVES INTO A STRONGER COMMITMENT NOT TO FOLLOW BEGGAR-THY-NEIGHBOR TRADE POLICIES, AND

71. B. SET MORE AMBITIOUS GOALS FOR THE MULTILATERAL TRADE NEGOTIATIONS, UNDERSCORING GOVERNMENTS' CONTINUED COMMITMENTS TO AN OPEN AND GROWING TRADING SYSTEM.

72. C. ESTABLISH THE OBJECTIVE OF GROWING WORLD TRADE AS AN ELEMENT OF ECONOMIC POLICY PLANNING.

THE STATE OF PLAY

73. THE DOMINANT FACTORS ARE:

74. --CONTINUED FOREIGN CONCERN OVER PERCEIVED U.S. PROTECTIONISM, DILUTED SOMEWHAT BY RECENT U.S. ACTIONS, PARTICULARLY TREASURY'S REJECTION OF THE STEEL INDUSTRY REQUEST FOR COUNTERVAILING DUTIES;

75. --GROWING RECESSION INDUCED PROTECTIONIST PRESSURE IN THE U.K. AND IN SUCH OTHER DIVERSE COUNTRIES AS BRAZIL AND FINLAND, WHICH COULD TRIGGER POLITICALLY AND ECONOMICALLY DESTABILIZING BEGGAR-THY-NEIGHBOR ACTIONS AND REACTIONS;

76. --SLOW PROGRESS IN THE MULTILATERAL TRADE NEGOTIATIONS, WITH PARTICIPANTS COMING UNDER DOMESTIC PRESSURE TO GUT THE NEGOTIATIONS.

77. --A CONSEQUENT SENSE OF DRIFT.

SECRET

SECRET

PAGE 17 STATE 251836 TOSEC 160270

78. THERE IS NO CONSENSUS ON EITHER THE OBJECTIVES OR TIMETABLE FOR THE TRADE NEGOTIATIONS. WITHOUT THIS CONSENSUS IT IS UNLIKELY THAT PROTECTIONIST FORCES CAN BE CONTAINED BY AD HOC MEASURES.

79. AD HOCERY HAS THUS FAR BEEN SUCCESSFUL BUT IN PART BECAUSE THE U.S. HAS BEEN THE FOCAL POINT AND HAS AVOIDED RESTRICTIONIST MEASURES. NOW OTHER COUNTRIES ARE COMING UNDER INCREASING PRESSURE. WE CANNOT COUNT ON EITHER THEM OR THE U.S. TO CONTINUE RESISTING SUCH PRESSURES IN THE ABSENCE OF (1) A BROADER INTERNATIONAL COMMITMENT NOT TO TAKE RESTRICTIVE ACTIONS, AND (2) VISIBLE PROGRESS IN THE MTNS TO RESOLVE THE UNDERLYING TRADE PROBLEMS.

CONCLUSIONS

80. ACCORDINGLY, AT THE SUMMIT WE SHOULD PROPOSE THAT THE PARTICIPANTS:

81. A. REAFFIRM THEIR COMMITMENT TO AN OPEN WORLD TRADING SYSTEM AND THEIR RESOLVE NOT TO TAKE TRADE RESTRICTIVE ACTIONS TO DEAL WITH CURRENT ECONOMIC DIFFICULTIES ON EITHER AN ACROSS-THE-BOARD OR A SECTORAL BASIS;

82. B. ANNOUNCE THEIR DETERMINATION TO SIGNIFICANTLY LOWER TARIFF AND NON-TARIFF BARRIERS TO TRADE, INCLUDING AGRICULTURE, IN THE COURSE OF THE MULTILATERAL TRADE NEGOTIATIONS AND TO AIM TO CONCLUDE THE NEGOTIATIONS DURING THE SUMMER OF 1977;

83. C. ANNOUNCE A RECOMMITMENT TO STRENGTHEN TRADING RELATIONS WITH DEVELOPING COUNTRIES, INCLUDING APPLICATION OF SPECIAL AND DIFFERENTIAL TREATMENT WHERE FEASIBLE AND APPROPRIATE, STATING ALSO THAT DEVELOPING COUNTRIES SHOULD GRADUALLY ASSUME NORMAL TRADING RESPONSIBILITIES IN KEEPING WITH THE STRENGTHENING OF THEIR ECONOMIES.

84. D. SAY WE ARE READY TO SIGNIFICANTLY MODIFY OUR PROPOSAL FOR A SUBSIDIES/COUNTERVAILING DUTY CODE TO BRING U.S. LAW INTO FULL CONFORMITY WITH INTERNATIONAL RULES,
SECRET

SECRET

PAGE 18 STATE 251836 TOSEC 160270

PROVIDING OUR TRADING PARTNERS JOIN US IN OUTLAWING THE MORE EGREGIOUS SUBSIDY PRACTICES.

85. E. EXPRESS A WILLINGNESS TO MEET THE SHORT-RUN PROBLEMS OF THE STEEL INDUSTRY BY NEGOTIATING AN INTER-

NATIONAL AGREEMENT COVERING TRADE IN STEEL OVER THE NEXT TWELVE MONTHS DESIGNED TO PREVENT THE UNILATERAL ERECTION OF RESTRICTIONIST BARRIERS.

86. F. PROPOSE THAT A LONGER RANGE NEGOTIATION COVERING THE STEEL SECTOR AS WELL AS SUCH OTHER SECTORS AS ALUMINUM, COPPER, FOREST PRODUCTS, ELECTRICAL MACHINERY, BE LAUNCHED IN THE MTN WITH THE AIM OF DEVELOPING A COMPRE-

HENSIVE TRADE LIBERALIZING APPROACH INCLUDING REDUCTION OR ELIMINATION OF TARIFF AND NON-TARIFF BARRIERS, SUPPLY ACCESS AGREEMENTS, AND INCORPORATING GENERAL RULES ON SAFEGUARDS.

87. G. PROPOSE THAT NEGOTIATION OF A GRAINS RESERVES AGREEMENT BE CONCLUDED BY THE SPRING OF 1976.

88. THE ABOVE WILL BE VERY DIFFICULT TO OBTAIN. INTERNATIONALLY, THE U.K. AND PERHAPS OTHERS WILL STRONGLY RESIST A TIGHT COMMITMENT TO AVOID PROTECTIONIST PRESURES. FRENCH OFFICIALS WILL URGE GISCARD TO OPPOSE A MORE DYNAMIC MTN. AGREEMENT ON AN INTERIM STEEL ARRANGEMENT WOULD BE SUPPORTED BY THE EC WHICH HAS MADE SIMILAR SUGGESTIONS ITSELF.

89. DOMESTICALLY, WE WILL FIND GENERAL SUPPORT FOR A RENEWED COMMITMENT TO AVOID TRADE RESTRICTING MEASURES. HOWEVER, WE CAN EXPECT CONGRESS TO CRITICIZE ANY SUGGESTION THAT THE ADMINISTRATION HAS COMMITTED ITSELF AS A MATTER OF PRINCIPLE TO EXERCISE ALL ITS AVAILABLE LEGAL FLEXIBILITY AND IS NOT PREPARED TO USE THE TRADE ACT'S MORE PROTECTIONIST SECTIONS TO CLUB FOREIGNERS INTO ACCEPTING OUR NEGOTIATING POSITIONS IN THE MTN.

90. WE CAN EXPECT DOMESTIC CRITICISM OF PROPOSALS TO USE OUR MAXIMUM NEGOTIATING AUTHORITY IN THE MTNS. THE
SECRET

SECRET

PAGE 19 STATE 251836 TOSEC 160270

DOMESTIC AGENCIES AND STR WILL OBJECT EITHER ON TACTICAL GROUNDS (ACT LIKE A RUG MERCHANT) OR REFLECTING INDUSTRY CONCERNS, WILL ARGUE THAT U.S. PRODUCERS HAVE LESS TO GAIN FROM OPENING FOREIGN MARKETS THAN THEY HAVE TO LOSE FROM THEIR OWN. IMPORTANT ELEMENTS IN THE CONGRESS SHARE THESE VIEWS.

91. THE SUBSIDY CODE IS BEING WATCHED WITH PARTICULAR CARE. SENATE FINANCE AND HOUSE WAYS AND MEANS COMMITTEE MEMBERS ARE RELUCTANT TO ADOPT AN INJURY PROVISION IN OUR COUNTERVAILING DUTY LAW. MOREOVER, THERE IS A GROWING ANTAGONISM TO PROVIDING ANY SPECIAL TREATMENT FOR THE

DEVELOPING COUNTRIES. WE RISK NOT BEING ABLE TO OBTAIN CONGRESSIONAL SUPPORT FOR ANY MEANINGFUL PACKAGE IN THIS AREA.

92. ON BALANCE, HOWEVER, THE RISK IS WORTH TAKING. FAILURE TO PRESS FOR SIGNIFICANT PROGRESS IN THE MTN WILL RESULT IN A FURTHER WEAKENING OF THE TRADING SYSTEM. IT WOULD BE A CLEAR SIGNAL THAT THE U.S. AND THE MAJOR WORLD TRADING NATIONS HAVE NO VIABLE ALTERNATIVES TO DEAL WITH THE UNDERLYING TRADE PROBLEMS. PARTICULARLY IN THE

CURRENT ADVERSE ECONOMIC CLIMATE, THE ABSENCE OF MULTI-LATERAL TRADE LIBERALIZING SOLUTIONS WILL ONLY ENCOURAGE RESTRICTIVE UNILATERAL ACTIONS.

V. NORTH/SOUTH

93. WHILE THE SUMMIT MAY PRODUCE ONLY GENERAL STATEMENTS OF GOODWILL ON NORTH/SOUTH RELATIONS, IT OFFERS A GOOD OPPORTUNITY FOR US TO KEEP THE INITIATIVE AMONG INDIVIDUAL COUNTRIES BY PRESSING OUR PROPOSALS AND OUR VIEW OF THE PROBLEMS AHEAD.

U.S. OBJECTIVES

94. WE HAVE THREE BASIC OBJECTIVES:

A) TO PREVENT A BROAD COALITION OF LDC'S FROM CONSOLIDATING AGAINST US UNDER OIL STATE LEADERSHIP;

SECRET

SECRET

PAGE 20 STATE 251836 TOSEC 160270

B) TO ASSUME THE MEDIATING ROLE BETWEEN NORTH AND SOUTH, AND

C) TO DEVELOP OUR POLITICAL AND ECONOMIC INFLUENCE IN THE DEVELOPING WORLD THROUGH BILATERAL TIES WITH THE MOST POWERFUL AND DYNAMIC LDC'S.

THE STATE OF PLAY

95. YOUR SEPTEMBER 1 SPEECH AND THE FAVORABLE UNGA/SS OUTCOME HAS GIVEN US THE DOMINANT ROLE IN NORTH/SOUTH DIPLOMACY; IT STARTED A PROCESS OF NEGOTIATION IN WHICH THE REAL INTERESTS OF LDC'S (WHICH ARE MUCH MORE IN THE INDUSTRIAL WORLD THAN OPEC) EMERGE. OUR ABILITY TO PROTECT THIS SUCCESS DEPENDS ON DELIVERY ON OUR PROPOSALS, AND THEIR CONTINUING RELEVANCE. WE CAN MAKE A GOOD RECORD OF INITIAL ACTION ON THE FORMER (FAILURE OF THE COCOA NEGOTIATIONS TO PRODUCE A RESULT WE CAN ACCEPT IS THE MAIN EXCEPTION). ON THE LATTER, NEW PROPOSALS WILL BE NEEDED

(SEE BELOW).

96. PREPCON AGREEMENT TO RECOMMEND CREATION OF THE FOUR COMMISSIONS GIVES US THE LIMITED MEMBERSHIP FORUM AND ABOUT A YEARS' TIME TO BUILD SUPPORT BEHIND OUR INDIVIDUAL INITIATIVES. AT THE END OF THE YEAR (REALISTICALLY AFTER OUR ELECTIONS IN JANUARY OR FEBRUARY 1977) WE WILL FACE A NEW LDC EFFORT TO PUT OVER A GLOBAL DEAL. WHILE WE NEED NOT BE CONCERNED ABOUT SUCH AN EFFORT ON SUBSTANTIVE GROUNDS SO LONG AS WE ARE NOT DEMANDEUR ON OIL, IT WOULD HAVE THE POLITICAL EFFECT WE ARE SEEKING TO AVOID: THAT OF PROMOTING LDC SOLIDARITY UNDER OPEC LEADERSHIP. DELAY IN THIS TEST SERVES OUR INTEREST SINCE OPEC'S ABILITY TO

PLAY THE BIG MONEY GAME WILL DIMINISH AS ALL BUT SAUDI ARABIA & KUWAIT STOP ACCUMULATING FINANCIAL SURPLUSES.

97. MEANWHILE THE CRITICAL NORTH/SOUTH PROBLEM WILL BECOME THE FINANCING OF LDC PAYMENTS DEFICITS. LAST YEAR THE LDC'S FINANCED AGGREGATE DEFICITS OF \$30 BILLION (A THIRD OF IT DUE TO INCREMENTAL OIL COSTS). THIS YEAR THEY WILL FINANCE \$35 BILLION OR MORE. NEXT YEAR THE TOTAL
SECRET

SECRET

PAGE 21 STATE 251836 TOSEC 160270

MAY BE LESS, BUT WITH SOURCES OF FINANCING EXHAUSTED, THE PROBLEM WILL BE MUCH MORE ACUTE. MOST LDCS WILL BE UNDER PRESSURE, BUT MOST OF THE FINANCING REQUIREMENT WILL BE CONCENTRATED IN A FEW LARGE LDCS WITH CLOSE TIES TO US: BRAZIL, MEXICO, KOREA, TAIWAN. THE EMERGING PAYMENTS CONFIGURATION IS ONE IN WHICH THE LDC DEFICIT ABOUT EQUALS THE OPEC SURPLUS, WITH INDUSTRIAL COUNTRIES AS A BLOC IN BALANCE.

98. OPEC IS MOVING ALREADY TO PROVIDE ITS OWN MEANS OF FINANCING: IRAN, VENEZUELA, KUWAIT ARE PROPOSING A 1.5 TO \$2 BILLION FUND FOR THIS PURPOSE. EVEN THOUGH SMALL IN AMOUNT, SUCH A FUND WOULD GIVE OPEC CONSIDERABLE LEVERAGE OVER A RANGE OF LDC'S WHOSE FINANCING NEEDS ARE SMALL BUT OFTEN DESPERATE.

99. EUROPE IS ALSO MOVING TO ANSWER THE PAYMENTS PROBLEM. SCHMIDT'S ABOUT-FACE ON THE SDR-AID LINK IN SEPTEMBER MAY NOT BE FINAL, BUT BRITAIN AND FRANCE AT LEAST WILL GO TO THE SUMMIT TO PRESS SDR CREATION. THE GERMANS MAY PRODUCE A PROPOSAL ON DEBT RELIEF WHICH IS FOR US THE MOST DIFFICULT FORM OF FINANCING FOR LDCS. A DEBT MORATORIUM WOULD COST US NEARLY \$500 MILLION A YEAR, MOSTLY OUT OF OUR BILATERAL AID PROGRAM. WE CAN EXPECT MORE DEBT RELIEF PROPOSALS OUT OF THE FRENCH.

100.WE CAN EXPECT COMMODITY MARKETS TO FIRM WITH THE RECOVERY, THEREBY WEAKENING LDC PRESSURE FOR STABILIZATION AGREEMENTS, BUT PERHAPS STRENGTHENING EFFORTS AT CARTELI-ZATION IN SEVERAL AREAS (BAUXITE, COPPER, IRON ORE). COMMODITY NEGOTIATIONS PER YOUR SEPTEMBER SPEECH WILL BE AS MUCH IN OUR INTEREST AS THE LDC'S.

CONCLUSION

101.THE CONCLUSION TO DRAW IS THAT WE WILL NEED A MAJOR INITIATIVE AT THE DECEMBER CONFERENCE IN ORDER TO KEEP US IN CONTROL OF THE NORTH/SOUTH PROCESS. THE SUMMIT WOULD APPEAR (BEGIN UNDERLINE) NOT (END UNDERLINE) TO BE THE PLACE TO SURFACE SUCH A PROPOSAL, BECAUSE THE EUROPEANS WOULD CLAIM THEY PRESSED US INTO IT, AND BECAUSE
SECRET

SECRET

PAGE 22 STATE 251836 TOSEC 160270

IT WILL BE HARD OR IMPOSSIBLE TO GET INTERAGENCY AGREEMENT UNTIL NEW YORK IS SOLVED. ON THE OTHER HAND, WE WILL NEED ENOUGH OF AN INFORMAL PROPOSAL TO KEEP THE EUROPEANS FROM RUNNING AWAY WITH THIS ISSUE AT THE SUMMIT.

102.POSSIBLE US PROPOSALS INCLUDE THE FOLLOWING:

A) FORMATION OF A LARGE NEW FACILITY IN THE IMF WHICH WOULD CONVERT WITTEVEEN'S FUND INTO A FACILITY FOR LDCS ONLY. THE FUND WOULD BORROW FUNDS FROM ANY IMF MEMBERS WITH SURPLUS RESERVES, INCLUDING OPEC COUNTRIES, FOR RE-LENDING AT COMMERCIAL TERMS TO LDCS, PRIMARILY THE BETTER-OFF LDCS. THIS WOULD PROVIDE SHORT-TERM BALANCE OF PAYMENTS SUPPORT TO LDC'S IN AMOUNTS EXCEEDING THE FUND'S RESOURCES OR RULES. (TREASURY WILL BE RELUCTANT BECAUSE OF ITS DOCTRINAL RESERVATIONS ON IMF BORROWING, BUT MAY FIND THIS SOLUTION PREFERABLE TO THE ALTERNATIVES.)

B) A SPECIAL ISSUE OF SDR'S TO THE FUND TO PERFORM THE SAME FUNCTION. THIS WOULD BE A MEANS OF CREATING NEW LIQUIDITY WITHOUT GIVING THE LDC'S A "MONEY MACHINE". LENDING WOULD REMAIN SUBJECT TO FUND STANDARDS. TREASURY, BURNS, REUSS WOULD ATTACK AS INFLATIONARY (WHICH IT WOULD BE MILDLY).

C) AID/SDR LINK. CREATION OF SDR'S WOULD GIVE ALL LDC'S AND ALL INDUSTRIAL COUNTRIES NEW LIQUIDITY: THE LINK WOULD BIAS THE DISTRIBUTION FORMULA IN LDC FAVOR. TREASURY ARGUES THAT THIS WOULD RUIN THE MONETARY ROLE OF THE SDR (NOT A BAD RESULT; THE DOLLAR WOULD BENEFIT), CONSTITUTE BACKDOOR FINANCING (A CONGRESS UNABLE TO FACE UP

TO AID ISSUES MIGHT NOT BE ADVERSE TO THAT), AND LEAD TO UNCONTROLLED GENERATION OF NEW LIQUIDITY (THIS IS THE MOST SERIOUS ARGUMENT; BUT IT CAN BE MET BY STRUCTURING IN CONSTRAINTS). REUSS MIGHT SUPPORT. BUT MANY OF THE DEMOCRATIC EXPERTS ON FINANCE (FOWLER, ROSSA) WOULD OPPOSE.

103. THE OPTION OF TAKING NO INITIATIVE IS NOT ATTRACTIVE.

SECRET

SECRET

PAGE 23 STATE 251836 TOSEC 160270

IN THE END THE US WOULD HAVE TO ASSIST MOST IF NOT ALL OF LDC'S IN PAYMENTS DIFFICULTIES BECAUSE OF THE LARGE INVOLVEMENT OF US BANKS, BECAUSE OF OUR RELATIONSHIP WITH MANY OF THEM, OR BECAUSE THEY CAN ASSIST THEMSELVES AT OUR EXPENSE (BY DEFAULTING). A US INITIATIVE NOW WOULD SET UP ON TERMS FAVORABLE TO US RESOLUTION OF AN ISSUE WE MUST FACE ANYWAY.

RECOMMENDATION

104. THAT WE DEVELOP A NEW US PROPOSAL ON SHORT-TERM LDC PAYMENTS FINANCING FOR USE AT THE DECEMBER MEETING. THE SUMMIT SHOULD IDENTIFY THE PROBLEM, BUT NOT PROPOSE SOLUTIONS.

VI. ENERGY.

105. OUR UNDERLYING OBJECTIVES ARE (A) TO REDUCE THE OPEC MANIPULATION OF PRICE AND SUPPLY, AND THUS (B) TO RESTORE THE INDEPENDENCE OF ACTION OF INDUSTRIAL COUNTRIES UNDER US LEADERSHIP.

STATE OF PLAY:

106. DEADLOCK WITH THE CONGRESS HAS UNDERCUT OUR LEADERSHIP ON MOST ENERGY ISSUES.

107. IN THE ABSENCE OF AN EFFECTIVE U.S. LEAD FEW COUNTRIES HAVE TAKEN MORE THAN PERFUNCTORY ACTION ON CONSERVATION (BRITAIN, GERMANY AND FRANCE HAVE THE BEST PROGRAM), OR ON ALTERNATIVE SUPPLIES (NUCLEAR IS LAGGING IN ALL COUNTRIES, AND GOVERNMENT POLICIES ON PETROLEUM AND GAS PRICING AND TAXES INHIBIT DEVELOPMENT IN CANADA AND BRITAIN AS WELL AS THE U.S.).

108. DESPITE THIS WEAKNESS, FEWER INDUSTRIAL COUNTRIES NOW THINK THAT THE SOLUTION CAN BE FOUND IN NEGOTIATIONS WITH THE PRODUCERS THAN DID SIX MONTHS AGO. THIS IS BECAUSE OF REPEATED EVIDENCE AT PREPCONS I AND II OF PRODUCER RELUCTANCE TO NEGOTIATE ON OIL

PRICES, COMBINED WITH REPEATED FAILURE IN IEA EXERCISES

SECRET

SECRET

PAGE 24 STATE 251836 TOSEC 160270

TO IDENTIFY MULTILATERAL OIL DEALS THAT WOULD BE BOTH IN OUR INTEREST AND NEGOTIABLE. THE BEST WE COULD GET, MOST PEOPLE REASON, IS THE CURRENT PRICE INDEXED. THAT WOULD PROVIDE PROTECTION AGAINST AN EVENTUAL INCREASE IN THE REAL PRICE, BUT THE FUTURE IS SO UNCERTAIN THAT MOST COUNTRIES ARE NOT INTERESTED IN COMMITTING THEMSELVES. ONLY FRANCE SEEMS AT THIS MOMENT TO RETAIN INTEREST IN AN OIL COMMODITY AGREEMENT.

109. THE LATEST OPEC PRICE INCREASE WAS TAKEN LYING DOWN BY THE EUROPEANS, BUT IT HAS STIFFENED THE JAPANESE, WHO NOW TALK OF TAKING A FIRMER LINE WITH THE PRODUCERS.

110.-WITH THIS CONJUNCTURE, CHANCES NOW ARE FAIR THAT THE IEA WILL ADOPT ITS LONG TERM PROGRAM ON DECEMBER 1, WITH A MINIMUM SAFEGUARD PRICE AT ABOUT \$7 A BARREL. CANADA (WORRIED ABOUT HAVING TO SOFTEN ITS NATIONALISTIC STAND ON FOREIGN ACCESS TO CANADIAN ENERGY), JAPAN (WORRIED ABOUT DIET REACTION TO MSP)AND FRANCE (WHICH

SYMPATHIZES WITH THE MSP CONCEPT BUT WANTS TO PREEMPT ANY IEA ACTION AND IS TRYING TO GET THE EC TO BLOCK ACTION) EACH PRESENTS A PROBLEM. BUT ALL OF THESE RESISTANCES SEEM TO BE REDUCIBLE AS OF THIS POINT (OCTOBER 22).

111. THE UNITED STATES ALSO HAS A MAJOR POSSIBLE ACTION OPEN TO IT BETWEEN NOW AND THE SUMMIT. CONFEREES ARE NOW WORKING TO FINISH THE CONGRESSIONAL ALTERNATIVE TO THE FORD ENERGY PROGRAM. THE EMERGING BILL WILL HAVE MOST OF THE PROVISIONS WE WANT, EXCEPT OIL DECONTROL. BY LAW, OIL PRICE CONTROLS COME OFF NOVEMBER 15. CONGRESS IS PLEDGED TO COMPLETE ACTION BEFOREHAND. THE PRESIDENT CAN THUS GO TO THE SUMMIT WITH AN AGREED BILL, THE BEST HE CAN GET BUT WITH A LOW CONSERVATION CONTENT. OR HE CAN VETO OR PLAN TO VETO THE HOUSE-SENATE BILL. THE PRESIDENT'S WILLINGNESS TO FACE THE UNPOPULARITY OF A VETO ON OIL PRICE DECONTROLS IS HIS MOST IMPORTANT ENERGY CARD VIS-A-VIS THE EUROPEANS AND JAPANESE.

112. IN THEIR NEW TOUGH MOOD, THE JAPANESE ARE TALKING

SECRET

SECRET

PAGE 25 STATE 251836 TOSEC 160270

ABOUT USING THE SUMMIT TO "COMPLETE CONSUMER SOLIDARITY" (I.E., BRING THE FRENCH INTO IEA). WE HAVE, HOWEVER, NO INDICATION FROM PARIS THAT THIS WOULD BE FEASIBLE; IF ANYTHING THE GUALLISTS ARE EVEN MORE OPPOSED TO MEMBERSHIP NOW THAN LAST YEAR, WHEN THEY WON A CABINET DEBATE ON THE QUESTION.

CONCLUSION:

113. THE MOST IMPORTANT THING IS THAT THE PRESIDENT HAVE MADE UP HIS MIND ON OIL DECONTROL BY THE TIME HE LEAVES FOR THE SUMMIT. FURTHER UNCERTAINTY ON THIS ISSUE -- THE KEY TO THE ADMINISTRATION'S ENERGY POLICY -- WOULD BE DESTRUCTIVE. THIS IS PARTICULARLY TRUE SINCE THE PRESIDENT IS SCHEDULED TO LEAD OFF ON ENERGY. THE EUROPEANS AND JAPANESE WILL BE NERVOUS ABOUT AN ENERGY POLICY BY VETO. BUT EVEN WITH DECONTROL BY VETO, THE US WOULD RECOVER SOME OF ITS LOST PRESTIGE IN ENERGY. THE PRESIDENT HAS ENOUGH STRENGTH TO SUSTAIN A VETO, PROVIDED HE GIVES SOME OR ALL OF THE \$2 IMPORT FEE.

114. WITH SUCH A BASE, THE SUMMIT CAN GIVE A SENSE OF DIRECTION ON TWO ISSUES: NEGOTIATIONS WITH THE PRODUCERS AND REDUCED DEPENDENCE. ON THE FIRST IT WOULD BE WORTHWHILE TALKING THROUGH THE ISSUE: THE DAMAGING ECONOMIC AND POLITICAL EFFECTS OF HIGH OIL PRICES; THE RELATIVE UNATTRACTIVENESS OF INDEXATION (IT GIVES YOU PROTECTION AGAINST REAL PRICE INCREASES, BUT RATIFIES

CARTEL GAINS AND EXPOSES POLITICAL LEADERS TO CHARGES THEY ARE CONSPIRING WITH PRODUCERS TO PUT PRICES UP, AND MAKES CARTEL MANAGEMENT EASIER); THE UNLIKELIHOOD OF OBTAINING A CUT IN PRICES, AND THEREFORE THE DIFFICULTY OF ATTEMPTING TO NEGOTIATE PRICES WITH THE PRODUCERS. ON THAT BASIS, WE ARE FORCED BACK ON WHAT WE CAN DO WITHIN OUR OWN BORDERS. THE SUMMIT SHOULD RECOMMIT IEA MEMBERS AND FRANCE TO LESSENED DEPENDENCY.

115. THERE IS LIKELY TO BE LITTLE ADVANTAGE, AND MUCH POTENTIAL MISCHIEF, IN FOLLOWING THE JAPANESE IDEA OF TRYING TO GET FRANCE IN THE IEA. GISCARD HAS NO

SECRET

SECRET

PAGE 26 STATE 251836 TOSEC 160270

INTERNAL POLITICAL BASE FOR SUCH A MOVE, EVEN IF HE WANTED TO MAKE IT. ATTEMPTS TO NEGOTIATE WITH FRANCE NOW WOULD ONLY DELAY THE LONG TERM PROGRAM, AND DEMORALIZE THE AGENCY. THE JAPANESE SHOULD BE TURNED OFF IN ADVANCE. INGERSOLL

SECRET

NNN

Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: TOSEC, INDUSTRIALIZED NATIONS, ECONOMIC PROGRAMS, PLANNING MEETINGS, SUMMIT MEETINGS
Control Number: n/a
Copy: SINGLE
Draft Date: 23 OCT 1975
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975STATE251836
Document Source: CORE
Document Unique ID: 00
Drafter: PHBOEKER/EUR/RPE:EPREEG:JB
Enclosure: n/a
Executive Order: X3
Errors: N/A
Film Number: D750367-0849
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19751028/aaaaaype.tel
Line Count: 1193
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN SS
Original Classification: SECRET
Original Handling Restrictions: STADIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 22
Previous Channel Indicators: n/a
Previous Classification: SECRET
Previous Handling Restrictions: STADIS
Reference: 75 SECTO 16028
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 27 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <27 MAY 2003 by CunninFX>; APPROVED <07 OCT 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: STRATEGY PAPER FOR SUMMIT
TAGS: PFOR, US
To: SECRETATRY
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006